

1 **REBUTTAL TESTIMONY OF**
2
3 **KEVIN MARSH**
4
5 **ON BEHALF OF**
6
7 **SOUTH CAROLINA ELECTRIC & GAS COMPANY**
8
9 **DOCKET NO. 2004-178-E**
10

11
12 **Q. ARE YOU THE SAME KEVIN MARSH WHO HAS PREVIOUSLY**
13 **TESTIFIED IN THIS MATTER?**

14 **A. I am.**

15 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

16 **A. The purpose of my testimony is to correct misunderstandings**
17 **contained in Dr. Dismukes' testimony concerning the Commission's "Phase-**
18 **In" Order in Docket No. 83-307-E and to explain why his proposed**
19 **regulatory treatment for the sales to NCEMC is incorrect.**

20 **Q. PLEASE DESCRIBE KEY TERMS OF THE COMMISSION'S ORDER**
21 **IN DOCKET NO. 83-307?**

22 **A. In Order No. 84-142, the Commission placed into rates SCE&G's**
23 **investment in the V.C.Summer Nuclear Station. But, in response to the**
24 **resulting reserve margin (47%) and the size of the proposed rate increase**
25 **(34%) the Commission decided to place outside rate base investment**
26 **equivalent to 400 MW of system capacity at average system cost for future**
27 **"phase-in" to rates.**

1 **Q. WHAT SITUATION WAS THE COMPANY FACING IN 1984?**

2 **A.** In the 1960s and early 1970s, electric load was growing rapidly
3 throughout the country, particularly in the Southeast. Between 1965 and
4 1973, demand on SCE&G's system more than doubled. In 1970 alone,
5 SCE&G's demand increased 13%.

6 In response to this demand growth, SCE&G like other utilities around
7 the country embarked on large-scale construction programs. Construction of
8 the V. C. Summer Nuclear Station, the Fairfield Pumped Storage Facility and
9 Williams Station all began in the period 1970-72. The new investment
10 represented by these three plants was greater than the Company's entire rate
11 base in 1970.

12 A combination of factors in the mid-1970s put the energy economy
13 into a tailspin. The Arab Oil Embargo of 1973 touched off a period of serious
14 financial turbulence in the United States, with double-digit inflation, high
15 unemployment, a sustained recession, and soaring interest rates. The load
16 growth the Company counted on to support its construction program did not
17 materialize. By the end of 1973, growth in electric demand had dropped to
18 less than half its pre-1973 levels.

19 When Summer Station was completed and added to rate base in 1984,
20 the requested retail rate increase was \$192 million, or 34%. The Commission
21 granted an increase of \$133 million, or a 23% increase in retail rates. A

1 substantial part of the reduction in the request related to the 400 MW Phase-
2 In discussed above. With 100% of its generating capacity in rate base, the
3 Company's reserve margin would have been 47%. With the 400 MW
4 deferral, the Company's reserve margin fell to approximately 32%. Order
5 No. 84-142.

6 **Q. HOW DID THE PHASE-IN WORK?**

7 A. The Commission concluded that Summer Station was a very efficient
8 unit, and that it was fully "used and useful." However, the Commission
9 found that the resulting 47% reserve margin justified the phase in of
10 investment related to 400 MW of system capacity. This 400 MW Phase-In
11 was valued at system average generation cost, and was held in a regulatory
12 asset account on which the Company was allowed to book carrying costs at
13 its weighted average cost of capital. Even with the 47% reserve margin, the
14 Commission did not find that any portion of SCE&G's generation plant was
15 not "used and useful." The Commission allowed the Company to recover the
16 full operating and maintenance and fuel costs of the system. The Company
17 was specifically allowed to recover depreciation expense on the value of the
18 400 MW of capacity held in the deferral account. The net amount deferred
19 (less depreciation), with carrying costs, was returned to rate base three years
20 later by Order No. 87-682.

1 **Q: HOW DID THE COURTS RESPOND TO THE COMMISSION'S**
2 **ORDER?**

3 **A.** The South Carolina Supreme Court upheld the Commission's decision
4 including the decision to allow depreciation related to the 400 MWs in retail
5 rates. The Court's opinion reads as follows:

6 *It should be noted that the PSC adopted the present rate base plan to*
7 *"phase-in" the cost of the new V.C. Summer Nuclear Station. The*
8 *term "phase-in" refers to the bringing into consumer rates over a*
9 *period of time, the investment cost of a new generating plant to avoid a*
10 *single, huge rate increase or "rate shock." Obviously, the operational*
11 *capacity of a new plant cannot be "phased-in," and thus, one method*
12 *to lessen the blow to the customers is to "phase-in" the cost. The*
13 *objective of rate base "phase-in" plans is to prevent "rate shock" to a*
14 *utility customer when a new plant is brought on line. Scotto "Post-*
15 *Operational Phase-in of Utility Plant: Prolonging the Inevitable," 112*
16 *Public Utility Fortnightly 28, September 1, 1983. Under the "phase-*
17 *in" plan, presently before this Court, there is no dispute that all of*
18 *SCE&G's generating facilities are, in fact, in service and depreciating;*
19 *therefore, an allowance for this depreciation has a sound basis under*
20 *the facts of this case.*

21
22 Hamm v. South Carolina Public Service Comm., 294 S.C. 320, 364 S.E.2d
23 455, 457 (S.C. 1988).

24 The Court quoted with approval testimony of the Consumer
25 Advocate's expert: "There is simply more capacity than the company needs to
26 use. It would be wrong to ascribe the surplus to any one particular plant." Id.

27 **Q: HOW DOES DR. DISMUKES' PROPOSAL COMPARE WITH THE**
28 **400MW PHASE-IN?**

1 **A:** The differences are quite stark between the 400 MW Phase-In and Dr.
2 Dismukes' proposal to remove a portion of the Jasper investment and allocate
3 it to the wholesale market.

4 1. In 1984, there was no specific customer for the 400 MW subject to the
5 Phase-In. Today, 350 MW of system capacity has been successfully
6 placed on the market, and 250 MW was placed before construction of the
7 Jasper Plant began.

8 2. In 1984, the reserve margin on SCE&G's system was 47% without the
9 Phase-In and 32% with it. Today, SCE&G's reserve margin will exceed
10 18% only once --in 2004 when it will be 19%. When the rates established
11 in this proceeding go into effect in 2005, the reserve margin will be
12 17.7%. In this proceeding, reserve margins will never approach the 32%
13 that the Company experienced in 1984 after the Phase- In.

14 3. In 1984, the request for a 34% rate increase created concerns about rate
15 shock, and was an important factor motivating the Commission to adopt a
16 phase-in plan. In this case, the rate increase requested was 5.7% in the
17 Application, and will be 3.57% if the stipulation between the Commission
18 Staff and SCE&G is accepted.

19 4. In 1984, the Commission found that all SCE&G generation was used and
20 useful and specifically included in rate base 100%of the Company's
21 investment in its most recent plant. The Commission explicitly based the

1 Phase-In on system-wide capacity and valued the 400 MW at the average
2 value of that system capacity. Dr. Dismukes would exclude from retail
3 rate base investment in the Company's newest and most efficient gas fired
4 generation –a plant that is used regularly for serving native load customers
5 because of its efficiency.

6 5. Under the 1984 Phase-In plan, the Commission allowed SCE&G to
7 recover 100% of its operating and maintenance, fuel and depreciation
8 expenses related to all plants, including the expenses associated with the
9 400 MW of investment held outside of rate base. Dr. Dismukes proposal
10 is engineered so that SCE&G would not be allowed to recover any costs
11 from native load customers related to the investment he would exclude
12 from rate base.

13 6. While the 1984 Phase-In plan put 400 MW of investment outside of rate
14 base, it ensured that all the Company's generation remained committed to
15 system requirements and firmly under the Commission's regulatory
16 authority. Dr. Dismukes' proposal would permanently assign a significant
17 part of SCE&G's most efficient gas-fired generation plant to wholesale
18 markets that the Commission does not regulate.

19 **Q. PLEASE RESPOND TO DR. DISMUKES' PROPOSAL TO EXCLUDE**
20 **FROM RATE BASE CERTAIN INVESTMENT RELATED TO THE**
21 **JASPER PLANT AND TO TREAT THAT INVESTMENT AND THE**

1 **REVENUE RELATED TO THE NCEMC SALES AS A SEPARATE**
2 **CUSTOMER CLASS OUTSIDE OF REGULATION FOR RATE**
3 **MAKING PURPOSES. DO YOU AGREE WITH THIS SUGGESTION?**

4 **A:** No, I do not. From a ratemaking perspective, SCE&G has properly
5 accounted for both the cost and revenues related to the NCEMC sales and other
6 opportunity sales. We have not segregated either the costs or revenues related
7 to the sales into separate customer classes, but instead have attributed 100% of
8 the revenue from these sales "above the line" to regulated electric operations.
9 In other words, regulated customers receive 100% of the benefits of these
10 contacts.

11 **Q. WHY IS THIS THE APPROPRIATE REGULATORY TREATMENT?**

12 **A:** To the greatest degree possible, the regulatory treatment of costs and
13 revenues should reflect the substance of the transactions being accounted for.
14 The Company presented a 875 MW configuration for the Jasper Plant to the
15 Commission in Docket No. 2001-420-E. Part of the cost of that configuration
16 was to be supported by a 250 MW sale of system capacity and energy to
17 NCEMC. The 250 MW NCEMC sale is by no means the only opportunity sale
18 the Company is making out of system capacity. It is making opportunity sales
19 on an ongoing basis and crediting the revenue to the system. In addition, since
20 Docket No. 2001-420-E , the Company has sold an additional 100 MW of
21 system capacity and energy to NCEMC.

1 The most appropriate way to reflect these sales is to ascribe the revenue
2 from them to the system as a whole. This treatment properly reflects the fact a)
3 that the sales are system sales and not unit specific sales, and b) that the 875
4 MW Jasper configuration, and the 250 MW NCEMC sale, were presented and
5 approved as a unified package for the SCE&G's electric system as a whole. To
6 now segregate out parts of the Jasper investment and parts of system revenue
7 for special treatment is inconsistent with the basis on which the plant was sited,
8 the basis on which the 250 MW sale was negotiated, and the basis on which the
9 opportunity sales are supplied with system capacity. It would also require the
10 Commission to give different regulatory treatment to the 250 MW sale than it
11 gives to other similarly situated sales.

12 **Q: WHAT SUPPORT DOES THE 1984 400MW PHASE-IN PROVIDE**
13 **FOR DR. DISMUKES' PROPOSAL?**

14 **A.** None. The differences between what Dr. Dismukes proposes and what
15 the Commission ordered in 1984 are pervasive and fundamental. The 400
16 MW Phase-In does not provide support for Dr. Dismukes' proposal, but
17 instead demonstrates that his proposal is unreasonable and is out of step with
18 sound regulation as historically applied by this Commission.

19 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

20 **A.** Yes, it does.